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C O N F I D E N T I A L SECTION 01 OF 03 MANAGUA 000481

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STATE FOR WHA/CEN, WHA/AND, WHA/EPSC, INR/IAA, AND EEB/OMA
STATE PASS TO OPIC AND USOAS
DEPT PASS TO USAID/LAC FOR D BATTLE
USDOC FOR 4332/ITA/MAC/WH/MSIEGELMAN
3134/ITA/USFCS/OIO/WH/MKESHISHIAN/BARTHUR

E.O. 12958: DECL: 04/19/2018
TAGS: EFIN ECON PGOV NU
SUBJECT: NICARAGUA'S CENIS- A POTENTIAL FINANCIAL CRISIS

REF: A. MANAGUA 450

¶B. MANAGUA 443
¶C. MANAGUA 373

Classified By: Amb. Paul Trivelli for reasons 1.4 b&d

¶1. (C) Summary: On April 15, the Nicaraguan Central Bank announced the creation of an escrow account in which the Ministry of Finance deposited payments due on bonds issued as part of a bail-out of the financial sector in 2000-2001, generally known as CENIs. The account would be frozen until a judge lifts the sequestration order on the bonds. While such escrow accounts have been used in other countries, this account does not meet international standards (and may not exist as all), so Nicaragua finds itself in default on its domestic debt obligations. GON officials publicly insist that refinancing negotiations are taking place; but both BanPro and Bancentro, the banks holding the CENIs, say this is not true. Our interlocutors believe that all potential GON negotiators are waiting for President Ortega to decide on the next steps and issue orders. The crisis is already begun to have an effect on Nicaragua's financial system. According to both Bancentro and BanPro, Fitch rating service is considering downgrading Nicaraguan banks soon. Transactions in Nicaragua's bond market have fallen over 90% in the last two weeks. It is clear that for Ortega, the CENIs are essentially a political issue. He may well be indifferent to the costs to Nicaragua's financial sector. End Summary.

The Government Claims Good Intentions

¶2. (SBU) On April 15 Nicaragua was due to make USD 20.6 million in bond payments on the CENIs bonds to local banks BanPro and Bancentro. (CENIs are bonds issued to facilitate the rescue of four failed banks in 2000-2001 - Ref A). In order to stop the payment, on April 4, a district criminal court judge issued a sequestration order for the CENIs so they could be annotated as "payment suspended" (Ref B). The sequestration forced the banks into bond refinancing negotiations with a GON commission made up of the Attorney General Hernan Estrada and the Comptroller General Luis Angel Montenegro, with no representatives of the Central Bank or Finance Ministry.

¶3. (SBU) When the GON and the banks did not announce a refinancing deal by April 15, the Ministry of Finance (MHCP) and Central Bank (BCN) called a press conference to report that they had taken steps to signal to the international markets that the GON intends to honor its debts despite the judicial suspension. According to BCN President Antenor Rosales, MHCP deposited the April 15 payment in a specially created escrow account at BCN. He also stated that as soon as the sequestration order is lifted, the payment will be transferred automatically to BanPro's and Bancentro's accounts.

¶4. (C) According to international finance experts we have consulted, such escrow accounts have been used in the past in other countries when bond payments are caught in litigation -- the measure signals to international markets that the government intends to pay. However, escrow accounts are complicated, and usually require the local government to consult with representatives from international financial markets, rating agencies, banks, and lawyers, to gain their buy-in before the account is set up. Neither Fitch, nor the international financial institutions (IFIs), nor the regional bank superintendents were consulted in the creation of this particular account. By all objective standards Nicaragua is now in default on the CENIs and on all other GON paper and credit facilities due to cross-default clauses contained in most of these financial instruments. (Note: All Central American bank superintendents have a stake in the CENIs events because both BanPro and Bancentro are part of regional banking groups based in Panama. End Note.)

The Banks: No Where to Turn

¶5. (C) Both Bancentro President Roberto Zamora and BanPro General Manager Luis Rivas told the Ambassador that the escrow account is a "sham." They claim MHCP has no money deposited at BCN and that the GON has no intention of paying. Zamora stated that when Bancentro tried to redeem USD 1 million in coupon payments, his officials were turned away empty handed. From the banks' perspective, the GON has defaulted on its bonds. (Note: According to both bankers, only the CENIs reaching maturity in 2008 were sequestered. Although the judge's order indicated coupons from later maturity bonds should be sequestered, the judge did not understand the instruments and only sealed the bonds maturing in 2008. This allowed Bancentro to try to redeem non-sequestered coupons from bonds due to mature from 2009 to ¶2013. End Note.)

¶6. (C) Both Zamora and Rivas expressed serious concerns about the effect of this default on their Fitch credit risk ratings. Both Bancentro and BanPro have been in constant contact with Fitch over the last week. Fitch has had Nicaraguan banks under a "ratings watch" for the last couple of months, but may soon decide to downgrade all Nicaraguan banks holding GON paper. Lower credit risk ratings could result in international banks cutting lines of credit, a rise in interest rates charged to local banks, and credit facilities being recalled. These shifts would change the capitalization requirements of the banks, leading to a reassessment on interest rates for deposits and loans. If the crisis snowballs quickly, and the banks do not appear to be responding well, depositors could flee. The majority of depositors in both Bancentro and BanPro are large institutions; for BanPro 15% of their depositors represent 80% of their deposits. A higher cost of doing business will also affect Nicaraguan borrowers, the majority of whom hold USD variable rate loans.

¶7. (C) BanPro's position is more severe than Bancentro's. While both have acceptable capital to asset ratios, Bancentro's at 8.37% and BanPro's at 8.57%, BanPro holds USD 150 million in CENIs vs. only USD 40 million at Bancentro. (Note: This capitalization rate for BanPro is a correction over the rate presented in paragraph 9 of Ref B.)

Negotiations?

¶8. (C) While GON officials publicly insist that negotiations are taking place, both Zamora and Rivas claim to us in private that this is not true. Both bankers told us they stand ready to negotiate, but the GON commission is a constantly moving target. Although ostensibly comprised of Attorney General Estrada and Comptroller General Montenegro, Estrada has told the bankers he is no longer part of the commission, and their most recent main interlocutor has been Supreme Court (CSJ) Justice Chicon Rosales. The bankers feel that only negotiating with BCN President Rosales makes sense, because he is one of the few FSLN leaders who understands financial instruments and international markets, and of course, the CENIs were in fact issued by the BCN.

¶9. (C) BCN President Rosales has assured the Ambassador that the BCN intends to honor its debts, and he hopes that a serious commission will be named that can negotiate both a legal and financial solution to the issue. Both Zamora and Rivas believe that GON members are waiting for Ortega to make a decision on next steps and issue orders accordingly.

¶10. (C) GON objectives for the refinancing negotiations are unclear. Zamora believes the political hardliners such as Estrada and Montenegro are determined that the Ortega administration will not pay the CENIs at all. An observer of debt issues at the BCN stated that the objective of the GON's economic team is to pay the CENIs, but under terms that do no increase the nominal payment amount. Proposed terms being bandied about include replacing the current CENIs bonds with bonds maturing in 10-20 years and interest rates of 4-4.3%. Current CENIs expire in 2013, and pay an average annual yield of 8.3%. Rivas has said BanPro is willing to consider any deal that allows them to recover principal, the cost of funds, and administrative charges (about 2%.)

Staving Off Disaster

¶11. (C) IMF ResRep Humberto Arbulu has conveyed the dangers of the situation to the GON's economic team and is seeking a short-term solution. On April 9, IMF Deputy Managing Director Murillo Portugal sent a letter to President Ortega registering the IMF's concern regarding the potential impact the CENIs scandal will have on Nicaragua's financial sector and economy. The letter notes that the two banks involved hold 60% of the deposits in Nicaragua. Portugal encourages Ortega to find a way to contain the risk to the financial system. On April 18 Arbulu will meet with BCN President Rosales to convey the IMF Board's concern about the issue and its impact on the banking system, and request the GON's plans for settling the issue. We understand the IMF Board cannot complete the current six-month review by mid-May because of this situation, delaying a USD 16 million disbursement (Ref C). The World Bank Board has also put on hold approval of a USD 20 million disbursement for direct budget support.

¶12. (C) While the other shoe has yet to drop for Bancentro and BanPro, Nicaragua's bond market has taken a serious hit. Transactions fell more than 90% from USD 3.6 million on April 7, to USD 140,000 by April 9, to an average of USD 104,000 during the last week. On April 16, no one bought any GON paper during an open market auction.

¶13. (C) BanPro's Rivas states that several depositors have asked questions and expressed some nervousness, but there has been no withdrawal of deposits. BanPro is already exploring ways of isolating its Nicaraguan operations from the regional group. The regional superintendents are exploring possible joint actions with regard to Bancentro and BanPro.

¶14. (C) Bancentro's Zamora believes this attack on the two banks is all part of a coordinated plan to destroy the banks and the CENIs. He showed the Ambassador a March 28 letter from the Nicaraguan Tax Administrator claiming Bancentro owed USD 8.7 million in back taxes and fines due to underreporting going back to 2002. In his view the ultimate goal is to

destroy opposition leader Eduardo Montealegre, Finance Minister during the 2003 refinancing of the CENIs, by blaming any problems caused to Nicaragua's financial system by the CENIs on him. "It's war," Zamora said.

Comment

¶14. (C) Nicaragua's financial sector is holding its breath. For the moment markets are stable, but it is an uneasy calm. If it becomes clear that the GON is making no effort to refinance the CENIs and complete its payments, financial events could quickly snowball. For President Ortega, the CENIs are essentially a political issue. He may well be indifferent to the costs to Nicaragua's financial sector that this default will engender.
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